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E.O. 12958: N/A

TAGS: [BTIO](#) [ECON](#) [EINV](#) [ETRD](#) [CH](#)

SUBJECT: SOUTH CHINA OUTWARD INVESTMENT IN 2006

11. (U) Summary: In 2006, Chinese overseas investment surged by 32 percent and reached USD 16 billion, according to China's Ministry of Commerce. Last year Guangdong Province, which accounted for USD 600 million in total overseas investment, was first in the country again. The number of Guangdong-based enterprises with investments outside of mainland China increased to 1,600, while Guangzhou Municipality registered 20 new enterprises with investments overseas. Vietnam has recently emerged as a particularly desirable - and lucrative - destination for South China firms. Established companies here continue to look at, but are not necessarily investing in older, more established companies in the U.S., even as many U.S. states, among them California, Washington, Hawaii, Virginia, and Illinois, send commercial delegations here. Guangzhou Municipality has a reward system in place for local companies, with outstanding overseas investment performance, to encourage their continued investment. End Summary.

Guangdong and Guangzhou's Outward Investment

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12. (U) According to Fu Haikun, Director of the Foreign Economic Cooperation Division of the Guangdong Province Department of Foreign Trade and Economic Cooperation, Guangdong, by year end 2006, had registered more than 1,600 enterprises with foreign investments. The total overseas investment for the province this past year equaled USD 600 million. The primary destinations for Guangdong's outward investment were Hong Kong, Macau and developing countries in Southeast Asia such as Vietnam and Cambodia. Among these destinations, Hong Kong accounted for over 50 percent of the total. Guangdong Province approved investment applications for 60 enterprises to invest in the USA, but only 20 enterprises actually invested there. In recent years, Guangdong has seen an increase of new overseas investment in manufacturing industry, but a decrease in civil engineering projects. Among the 20 new enterprises approved by Guangzhou Municipality that made outward investment in 2006, most were small and medium enterprises (SMEs), with less than USD 15 million in export value per year. These enterprises included private companies as well as State-Owned Enterprises (SOEs).

13. (U) Since 2005, multi-national companies based in Guangdong in the manufacturing and telecommunications sectors have been increasingly investing overseas. These companies include telecommunications equipment makers Huawei and ZTE; electronics manufacturers Gree, Midea, TCL; audio equipment maker Guangzhou Guoguang Electric Company and Guangzhou Pearl River Piano Group Ltd., which date back to 1951 and 1956, respectively.

Guangzhou-based outward investment favors Hong Kong, Macau, as well as Australia, Brazil, India, and Vietnam, with Hong Kong and Macao accounting for half. The outward investment mainly goes to the development of sales networks and service agents, with the exception of a plastic sealing tape plant set up in Sao Paolo, Brazil. As has been the case for many years, Hong Kong - with its proximity and cultural affinities - has been the first choice for Guangdong outward investment. As a global center of information, logistics and finance, Hong Kong enjoys a well developed capital market and has an established set of laws and regulations. Director Fu stated that a company originally from South China can best expand its business by becoming listed in Hong Kong.

Guangdong Province Invests in Southeast Asia

¶4. (U) Due to its close proximity, its relatively stable political and sound investment environment, Southeast Asia is also very attractive to Guangdong enterprises. TCL (based in Huizhou) has established a color TV plant in Vietnam; Midea (Shunde) is building an industrial park there for the purpose of manufacturing small electronic appliances; and Guangzhou Cigarette Plant is expanding in Cambodia.

Vietnam: A Major Destination for South Chinese Investment

¶5. (U) In light of its low labor costs, large potential market, rapid growth (more than 8% annually in recent years), and the relatively stable political environment, countries like Vietnam offer companies in South China a suitable location for investment. In Vietnam, the average labor cost is about USD 40 per month, lower than China's USD 100. After WTO ascension, the Vietnamese government added initiatives/incentives to attract Chinese

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investment, which include establishing industrial parks and sending trade missions to China to promote Vietnam. In November 2006, Vietnam's commerce minister led a delegation to China and participated in an event held in Guangzhou that attracted over 500 enterprises. In the first quarter of 2007, Guangzhou registered two more enterprises that applied to build factories in Ho Chi Minh City.

South China Eyes the Rest of the World

¶6. (U) Eastern Europe and Africa are also new destinations for Guangdong's outward investment. Huawei and ZTE have projects underway in Africa, the Middle East, Russia and South America. Gree Electric Appliance Inc. has built an air conditioner manufacturing plant in Brazil.

A Lack of New Guangzhou Investment in the U.S.

¶7. (U) According to Zhang Liping, Director of Foreign Economic Cooperation Division of the Guangzhou Municipal Bureau of Foreign Trade, Guangzhou enterprises have been investing in the U.S. as far back as 1987. Enterprises based in Guangzhou have focused on Los Angeles and New York service and R&D sectors. However since 2004, no other companies with plans to invest in the U.S. have been registered with Guangzhou Municipality. Zhang pointed to the overall lack of contact with the U.S. business community and to strict U.S. visa policies, which have had an impact on local businessmen and official travel, even though more than 1,000 officials and businessmen visited the U.S. in October 2005 as part of delegation to promote investment and trade. In 2005, two delegations from Virginia and Illinois traveled to Guangzhou to promote investment opportunities, but both visits were unsuccessful. California, Hawaii, and Washington have all sent trade missions headed by their respective governors or vice-governors.

Encouraging Outward Investment

18. (U) Guangdong has generally encouraged enterprises to make outward investment and become more involved with economic globalization, according to Director Fu. By helping implement the policies issued by the Central Government and by providing services, the provincial government is building a platform for local enterprises to share information and promote cooperation. On the other hand, the Guangzhou Municipal government does play an active role and acts as an information resource for local enterprises contemplating outward investment. The Economic Cooperation Division collects overseas commercial information, makes information available on its official website, arranges overseas visits for local businessmen to meet foreign counterparts, hosts investment promotion programs for visiting foreign business delegations, and distributes brochures on the overseas investment environment to Chinese businesspersons. An investment delegation, spearheaded by Guangzhou Municipality, which visited Australia in 2006, resulted from an earlier visit led by Guangdong Party Secretary Zhang Dejiang.

Rewarding Companies with Outstanding Outward Investment

19. (U) Since making outward investment is the "decision" of individual enterprises, the provincial and municipal governments do not provide funding or subsidies to Chinese multinationals, according to local officials. To recognize outstanding the foreign investment performance by individual Chinese companies, the municipal government conducts annual evaluations, and awards the outstanding company a small amount of cash. Among those recognized have been Guangzhou GuoGuang Electric Company, with customer service offices set up in Europe and the U.S., and the Guangzhou Pearl River Piano Group Ltd., a Chinese piano manufacturer with sales networks in the U.S. that increased its market share there from 5 percent to more than 10 percent in recent years.

Improving How Guangzhou Promotes Outward Investment

10. (U) Guangdong provincial and municipal officials said they would continue encouraging local enterprises to invest overseas and become

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strong players in the world market. Director Zhang suggested that the municipal government might streamline the approval procedures for companies seeking to invest overseas, improve the information services provided by the government to local enterprises, and increase the support from Chinese financial institutions. However he cautioned that these changes would only be possible with the guidance and support from the central government.

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